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INFLATION AND HIGH PRICES: THE FRENCH SITUATION

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INFLATION of paper circulation in France has been the object of much discussion abroad. It has perhaps never been thoroughly understood because it has so many side issues with which foreigners are not easily acquainted. I shall endeavor to sum up this question as completely and as compendiously as possible, giving you only facts and figures taken from official publications with a minimum of commentaries.

The Bank of France

In France, paper circulation takes the form of notes issued by the Bank of France (*Billets de la Banque de France*). The Bank of France is a private institution as to capital and management but is under the supervision of the Government which appoints its Governor and two Deputy-Governors. However, 15 Directors, called "*Regents*" and 3 Comptrollers, called "*Censeurs*" are elected by the 200 largest shareholders in a general meeting.

The Bank of France was established in 1800 by Napoleon to facilitate commercial relations by discounting and cashing bills of exchange as well as by opening current accounts. It is the only institution endowed with the right to issue notes that are accepted as legal tender on French territory. This issuing privilege was granted the Bank by virtue of its charter and of agreements concluded between it and the Government, which secure for the Government the following advantages:

1. The Bank pays a tax of 2% on the circulation of its notes.
2. The Bank offers the services of its 584 branches or agencies without charge, in all operations connected with the French Treasury (payment of Treasury arrears and interest on bonds, cashing drafts, issuing Government bonds or loans, supplying bullion, *etc.*).
3. The Bank credits the Government with three quarters of

its profit on the discount of commercial paper, when the rate of discount exceeds 5%.

4. The Bank credits the Government with the value of non-repaid notes a certain length of time after that type of note has been withdrawn from circulation. Then the Government assumes charge of repaying the old notes.
5. The Bank makes advances to the Government on terms that are agreed upon with the Bank and that are then passed by a law of Parliament.

In return for these advantages the Government gives the Bank its support under critical circumstances. In addition, a law can be passed by Parliament by virtue of which acceptance of the notes of the Bank is enforced as legal tender although the right to demand gold for such notes is suspended. This situation is what is called in France "*cours forcé*." "*Cours forcé*" was put into force at the beginning of the war, by a law dated August 5th, 1914.

Although no legal provision exists on the subject of backing the notes of the Bank of France by a fixed amount of gold, these notes in normal times were backed by reserves of about 30% of their value in gold. That this arrangement was adequate and satisfactory at all times is proven by the fact that during the most critical periods of French history, the value of these notes was never questioned.

Amount of Paper Circulation—Metallic Reserves

French paper circulation which in normal times amounted to about 6 billion francs has greatly increased since the beginning of the war, as is shown by the following table which gives the total amount of notes in circulation until 1920.

June, 1914	6 billion.
December, 1914	10 " 100 million.
June, 1915	12 " 200 "
December, 1915	13 " 300 "
June, 1916	15 " 800 "
December, 1916	16 " 600 "
June, 1917	19 " 800 "
December, 1917	22 " 700 "
June, 1918	28 " 500 "
December, 1918	30 " 200 "
June, 1919	34 " 400 "
December, 1919	37 " 200 "

According to the last statement of the Bank which was issued on April 15th, 1920, circulation at that date amounted to 37 billion 400 million francs.

Of course, it is impossible to expect an increase in gold reserve that would be proportionate to such an extreme increase in the circulation of notes. Nevertheless, an effort has been made in that direction and the reserve of the Bank of France during the war passed from 4 billion 141 million to 5 billion 585 million as the following table shows.

July 31st, 1914	4 billion	350 million
Dec. 24th, 1917	5 "	350 " 200 thousand
Dec. 24th, 1918	5 "	477 " 600 "
Dec. 24th, 1919	5 "	578 " 500 "
April 14, 1920	5 "	585 "

The total of the entries in gold, which amounted since the beginning of the war to 2 billion 404 million would have increased the reserve in gold to 6 billion 545 million if the necessity of paying in gold in foreign countries had not reduced them by 1 billion 67 million.

If we stop to consider that this increase in reserve took place during the war, when the richest part of France was invaded and when the French people, with their usual cautiousness, were decidedly inclined to hide their gold, it must be admitted that the readiness with which they exchanged their gold against notes of the Bank of France should be considered a proof of their patriotism as well as of their confidence in the soundness of the Bank.

Causes of Inflation in Circulation—Advances of the Bank to the French Government

Inflation in French paper circulation can be attributed to various causes. It is attributable chiefly to advances made by the Bank to the French Government of the following amounts:

December 31st, 1914	3 billion....900 million
December 31st, 1915	5 billion
December 31st, 1916	7 billion....400 million
December 31st, 1917	12 billion....500 "
December 31st, 1918	17 billion....100 "
December 31st, 1919	25 billion....500 "

At the present date, according to a statement of the Bank
(98)

of France dated April 15th, 1920, these advances amount to 25 billion 300 million francs.

During the war, these advances were required to finance war expenditures. They had to supply the difference between expenses and the income yielded on one hand by budgetary receipts, and on the other by the proceeds of loans issued by the Government since the beginning of the war.

The financial policy of the French Government during the war has been subjected to severe criticism. The Government has been accused of having too great recourse to credit and too little to taxation. In France, as elsewhere, winning the war was the sole object the Government had to have in view. The main factor in winning the war was the maintenance of a fighting spirit among the soldiers in the trenches as well as among the people at home. But conditions in France were very different from conditions in other countries. The richest provinces of France, covering one-sixth of the total area of the country, were invaded. According to statistics, out of a total population of 38 million, 8,392,000 men were mobilized. With the total masculine population between 20 and 47 years of age amounting to 9,336,000, the proportion of mobilized men was 89.3% which is far above the proportion anywhere else. This practically limited the population left at home to old people, women and children who were hardly able to accomplish the productive work necessary to pay taxes.

In addition, as fortunes are extremely divided in France, taxation, to be really productive, has to reach small patrimonies,—that means people with small means, petty merchants and bourgeois, clerks and Government employees, small proprietors and peasants.

The heads of these families were absent fighting in the trenches. To add to their suffering by imposing a heavy taxation upon them would have had a dangerous reaction among the soldiers who were so attached to their families. It was a risk that could not be taken. As a final consideration, the ranks of tax collectors were so depleted by mobilization that collection was rendered extremely difficult and the full assessment could not be collected. Thus, instead, mediocre fortunes were asked to contribute voluntarily to Government loans. The great bulk of these loans were taken by people of

wealth, private and public banks, manufacturers, *etc.* Taxation was resorted to as soon as peace was established. It will be greatly increased in this year's budget.

Since the end of the war, from the 31st of December, 1918, up to December 31st, 1919, circulation has increased seven billion francs. *A priori*, this figure for a year when hostilities ended seems very high. We must bear in mind that, during the period in question, expenses that the French Treasury had to meet were tremendous. First, as a result of the cessation of hostilities, the help that had been extended until then by foreign countries was withdrawn so that a large part of payments abroad had to be secured by purchasing exchange on the French market. Then the Treasury had to liquidate numerous war contracts, to maintain a considerable armed force on the Rhine as well as in remote countries of the Levant and the Far East, to continue allotments to families of soldiers until the end of the year and to pay demobilization bonuses—the salary of the French soldiers having been a nominal one during the war.

It must be noted that in reality the figure of 7 billion francs includes the redemption of German marks in Alsace Lorraine amounting to 2 billion francs and of money issued by the cities and townships in the invaded regions equalling about one million and a half francs. Consequently, these two items reduce the amount requested from the bank of France for Government expenses during this period to $3\frac{1}{2}$ billion francs. This figure is more than one billion francs less than that for 1918. The difference was obtained through taxation and loans that increased about 30%.

Since January 1st, 1920, there has been no increase in paper circulation. The variation recorded in the fortnightly statements issued by the Bank originates from the fact that payments can not coincide exactly with receipts. This commendable result has been brought about in spite of the cost of reconstruction in the invaded Departments, which comes up to 1 billion francs per month. Budgetary resources have been developed and long and short term loans have been placed directly with the French public.

Advances to Foreign Countries

Aside from advances to the French Government, another cause for the increase of paper circulation in France is the advances made to Allied countries. The Bank of France has made advances to some nations by discounting French Government Treasury Bonds for them. These advances amount to about 4 billion francs.

Commercial Operations of the Bank

The remainder of the increase in paper circulation at the present moment as compared with circulation before the war is accounted for by the commercial operations of the Bank, the discount of commercial paper, advances on securities, *etc.*

Discounting commercial paper rose considerably at the beginning of the war because of the necessity of rediscounting commercial paper that made use of the moratorium. However, until the end of 1919, discounting new commercial paper had very little to do with the increase in circulation, as the new bills that were discounted hardly exceeded the progressive reduction in bills that availed themselves of the moratorium.

The recent revival in business has evoked additional bills to be discounted and the Bank recently raised the discount rate from 5 to 6% and the rate of advances on securities from 5 to 6½%, in order to indicate the necessity of a policy marked by very great prudence.

Reduction in the Inflation in Circulation

Before studying the means of reducing inflation in French circulation, we must remember that, in normal times, the proportion of money circulation in France was always larger than in England or the United States. The reason for this lies in the fact that the thrifty Frenchman of the lower or even middle class likes to keep his money at home. As he has no bank account, he cannot pay his bills by check. Merchants are accustomed to payments in cash and do not make any effort to change the habits of their patrons. This habit of cash payments is so strong that even among the Banks the institution of clearing houses has met with less success than in other countries. In 1919, the Paris clearing house had only 34 members representing the large banking institutions.

When an opportunity for investment arises, as when the French Government issues a loan, money comes out from the drawers of investors. One may conclude from these facts, given the spirit of thrift among the French people, who pile up money ready for investment, that inflation in paper money is not so dangerous in France as it would be in some other countries where money is spent more freely.

Another very important factor lies in the fact that the people retain complete confidence in the notes issued by the Bank of France. This is due to the excellent management of this institution which has gained it its high reputation. For one hundred and twenty years, the Bank of France has shown itself equal to any emergency or difficulty. Three times only, during this long period, during the revolution of 1848, during the war of 1870 and during the last war, did the Government have to resort to "*cours forcé*," which I explained above. Every French citizen joins in the sentiment expressed in 1871 when the National Assembly decreed that "the Bank has deserved much from the country." No French peasant questions the fact that the notes of the Banque de France are as good as gold pieces. Accordingly, he does not hesitate to pile them up as if they were "Napoleons."

Nevertheless, the French Government is fully aware of the danger that lies in inflation in circulation and has formulated a plan to overcome the difficulty. The execution of this plan has already begun.

Of course any plan of this nature can be successful only if the total expenses of the Government are covered by budgetary receipts and the assistance rendered the Government by national savings. It is also contingent upon having these two categories of resources leave a surplus over governmental expenses permitting repayment to the bank.

New taxes have already been figured to cover and balance the ordinary budget that applies to all the administrative expenses of the Government and arrears in the public debt.

As for special expenses—which include the reconstruction of devastated regions as well as pensions to soldiers who are crippled permanently, and to the widows and orphans of soldiers killed during the war, the Government has decided to limit them to such an extent as will permit the French Treas-

ury to pay them on appealing to national savings without having recourse to the Bank of France.

Disbursements of this nature are, of course, to be taken out later from the indemnity that Germany has to pay France. It is a matter of justice to have Germany pay for the destruction she has wrought. That is why the French conception is legitimate that it is of primary importance to have the Treaty of Versailles enforced.

In the meantime the Government took action by itself in establishing "*Le Credit National*," a bank which was created to assist the reconstruction of devastated France. Its capital of 100 million francs was subscribed without difficulty and the institution has already issued a loan of 4 billion francs for reconstruction purposes to the French people with very successful results.

Another Bank, "*La Banque Nationale du Commerce Extérieur*" (The National Bank of Foreign Commerce) was created under the same auspices to assist French exports.

Banks in general influence paper money circulation only when they open credits that they have to offer for discount at the Bank of France. In this respect French Banks have maintained their traditional reputation for cautiousness during the war. Only since the armistice and in order to assist the revival of business have they allowed their debit account to grow and even then to a very limited extent.

The banks have helped the Government in its endeavour to induce private capital to cover the great needs of commerce and industry. Their appeal has been heard freely. From the day the armistice was declared until the 1st of April, 1920, 13 billion francs in issues have been realized towards that end.

Inflation in circulation is due to a certain extent to extravagance in purchases. These purchases are mostly from foreign countries where exchange is heavily against us at a moment when our exporting possibilities are decidedly hampered as a result of the havoc of the war. The Government has taken radical measures to lessen this evil, by forbidding the importation of articles of luxury. Purchases from foreign lands are thus reduced to raw materials and manufactured articles of prime necessity only.

These steps are only preliminary. They were necessary to

permit the last arrangement which was made between the Government and the Bank to produce results.

By this agreement which forms an amortization plan, passed with the Bank of France on the 14th of April, 1920, the French Treasury has fixed at 27 billion the maximum of advances which it is authorized to draw from the Bank. Thus, present advances which amount to 25 billion 300 million leave a margin of 1 billion 700 million to safeguard eventually against monetary disequilibrium between receipts and expenses that might happen at any time of the year. But it is already agreed that the figure of 27 billion will be reduced to 24 billion before the 31st of December, 1920. Moreover, it will be further reduced by at least 2 billion every year.

It must be noted that this figure of 2 billion constitutes a minimum and may be exceeded. Thus, inflation in circulation could be reduced to its pre-war basis in a maximum of 12 years. This seems a long time but we must bear in mind that inflation such as the present must be dealt with very carefully. France needs money to rebuild herself, money to develop her industry, money to develop that vast and rich Colonial Empire which is destined to play the part in her reconstruction now that your West played in your reconstruction after the Civil War. She needs money to pay her taxes. Too rapid a contraction in currency would certainly lead to a monetary panic which must be avoided before all.

France is the land of surprises. It is not a land of panic. Panic is contrary to the French temperament. We expect, knowing our own temperament, to emerge from the present crisis slowly but surely. Before our eyes, we have the great example of your country. After your great Civil War, you faced the same difficulties that now confront us. You overcame them and built that great and powerful financial, commercial and industrial empire which is now the United States. This is the example which is before the eyes of France as she turns towards her financial, commercial and industrial reconstruction.